

## New Reality of Risk ® Transcript

### The Changing Face of European Risk Management

#### Power and Utilities

*In our New Reality of Risk series Marsh and MMC experts, along with Marsh clients, share insights and experiences relating to topical risk issues of the day. This series of webcasts provides information and expert opinion on issues that could affect your business.*

*The current downturn in the global economy raises important questions about how organisations conduct their business – and particularly about how they assess and manage risk. This month’s webcast looks at the findings of some new European risk management research that Marsh has undertaken with independent research agency Ipsos, focussing on risk priorities, strategy, management and solutions.*

*Over 700 organisations were interviewed, across 12 European countries and 7 industry sectors. Our findings will be published in a series of reports - one for each of the industry sectors we’ve looked at - and an eighth report that will capture the overview findings for the whole of the European region.*

*In this audio briefing transcript, Mark Pollard, head of Marsh industry practices for Europe, the Middle East and Africa (EMEA) and the EMEA Power & Utilities Practice Leader, summarises some of the key findings in respect of the power industry.*



*Mark, we have heard a lot about the impact of the economic recession on various industries. How is the power industry doing?*

First of all, let me just point out that whereas the power and utilities risk report respondents were not just from the power industry, a minority of them came from other utilities industries, in particularly the water industry, I am going to concentrate my comments here on the power industry.

73% of all power respondents thought that their industry was going to be less affected than other industries as a result of the recession. That doesn't mean that it's not going to be affected at all; there are a number of ways in which it will be affected, two in particular.

The first one is that there is a reduction in industrial activity, manufacturing activity, which of course reduces the amount of power that is required by industry and that means reduced revenue for power companies. But that to some extent is mitigated by the fact that power customers are from industries that both lead and lag the recession; everything is not perfectly in phase and that to some extent leads to a sort of buffering effect for power companies.

The second big problem is the lack of capital for investment from the banks – it is difficult to borrow money in this period because there is not much money to be lent. And we see that this is delaying power projects to some extent.

When we think about the impact of the recession on the power industry we have got to remember that there's an underlying risk which faces the whole industry, and which has been facing the whole industry for a while - the future expectation that there might be an inability to match supply to demand. The expectation is that the increase in electricity demand will be very, very significant. In fact, the prediction is that there will be a 20% increase in demand by 2025, a very significant number.

The European Commission has set targets, the so-called 20:20:20 targets – by the year 2020 they want a 20% reduction in CO2 emissions, a 20% increase in energy efficiency, and a 20% presence of renewable energy in the overall electrical generation mix. That's a significant target and it will require an important set of infrastructural projects and infrastructural developments to be able to achieve that.

The expectation is that in the coming years there will be a progressive reduction in the use of fossil fuels - we won't be using petrol or diesel in cars, we will be driving electric cars; and we won't be using gas or oil to heat our homes, we will be using heat pumps (which is like a back to front air-conditioning unit).

The power industry is a public service industry which means that delivery is regulated. Margins are set over a long period in the context of the regulatory environment that the power companies operate in. These companies use long term contracts – fuel costs, electricity prices etc – and because of all this the industry is a very conservative industry.

***You say the power industry is a conservative industry. Could you give us some evidence of that from the research?***

Certainly. There are a number of indicators in the risk report that show that the power industry is tendentially a conservative industry. Two thirds of respondents have said that they are reviewing their approach to risk in light of the economic downturn, that's a big percentage. And three quarters of respondents told us that risk management has been raised to more senior levels in the company, in many cases to board level – that shows us that the most senior levels and the boards of companies are taking a direct interest in risk management in a way which is greater than they have done before.

We arranged the data in such a way that we can differentiate between the larger and smaller companies and we took a cut-off point of a turnover of EUR300m. And we see a very significant difference between larger companies and smaller companies in terms of the importance that they are giving to risk management. Larger companies are showing themselves to be far more conservative than the small companies, far more concerned about risk.

The appetite for risk has also reduced in power companies, more than in any other industry except for the financial institutions industry; in other words they have become more risk adverse, and only the financial institutions industry shows a greater risk aversion in light of the economic downturn. Financial institutions industry's aversion to risk is absolutely to be expected and I think that the power industry's aversion is further evidence of their conservatism.

Another interesting fact is that of all the industries, including retail industries, telecommunications - all the industries that we looked at, the concern about customer default is the highest in the power industry. 43% of respondents spontaneously said that they were concerned about customer default. So it is showing itself to be a very prudent, very conservative and far-sighted industry.

***So what types of risk are the power companies really concerned about?***

It was interesting that in unprompted questions where we didn't actually indicate the types of risks but just asked them generally what type of risks they were concerned about, there was almost no mention at all of hazard type risks - property risk, fire risk, machinery breakdown – which is little bit unusual, a little bit surprising. The power industry is an industry that has big complicated machinery - transmission grids, distribution grids - and hazard risks are usually at the forefront of risk managers' minds. That they didn't answer in this case is probably due to the fact that the context of this survey was really around the consequences of the economic downturn. In fact, when we did ask specific and prompted questions, these confirmed that the areas of concern around technology risk, the consequence of unplanned outages on the business, these are still a big concern to power companies.

The risks that were mentioned spontaneously were financial, macroeconomic risks and strategic and operational risks. Two thirds of the respondents talked about financial and macroeconomic risks and over half the respondents talked about strategic and operational risks. By far the biggest risk that was mentioned in the survey across a variety of questions and in a variety of areas was credit risk; as I said before 43% spontaneously said that credit risk was the biggest concern that they have at the moment.

***How confident is the power industry seen to be that it can manage the risks that it faces?***

Almost all respondents had some confidence in their ability to address their risks. But to a specific question, whether the risk management processes that they currently have in force were able to address the risks facing their organisations fully, in the power sector only 36% said that they were very confident that their current risk management processes could do that. That, even so, makes power the most confident of all

the industries – by comparison in the financial institutions industry only 20% expressed confidence. But if 36% think that they are very confident, that means that 64% are not very confident – that's almost two thirds that are not confident in their risk management processes.

***So what are the power companies going to be doing about all these risks?***

A variety of different actions were mentioned. For example, in relation to customers - looking at their credit worthiness more carefully, being more rigorous with payment terms. As far as suppliers go - reviewing and monitoring the contracts with suppliers, getting to know suppliers better. Insurers were mentioned – greater attention to their solvency and to the rating of insurers, and less reliance on a single insurer so spreading the risk further.

As we said earlier, the boards and senior management are taking a greater interest in risk and they are keen to introduce new risk management strategies to look at risk in more detail, to set up working groups and discuss risk more frequently.

About 60% of power companies say that they have a centralised approach to risk management as opposed to a devolved approach to risk management. Most of the companies are tending to stay about the same or predict that they will be about the same over the next months. But of those that are not staying the same, there is a significantly larger number that is going to increase centralisation. And the more senior people that we spoke to tended to favour a more centralised approach, which shows also an increased attention at the top level of the company to risk management.

***What are peoples' risk management budgets going to look like in the future and what will they be spending it on?***

That's a very interesting question indeed. Of all the respondents, only one respondent expected there be a little decrease in the risk management budget. Many expected the risk management budget to stay the same, but significantly more than a third expected the risk management budget to increase in next eighteen months. If you think of the economic context, there aren't many costs in businesses at the moment that people are expecting to increase so I think we were surprised that the risk management budget was likely to increase across such a significant percentage of respondents.

That's probably in some way driven by an expectation that insurance rates are going to harden; insurance will cost more. As we said before, risk aversion is either the same or people are becoming more risk averse and therefore are expecting to be spending more to maintain the same level of insurance or to buy more insurance.

When we asked people what they were intending to spend the money on, the extra budget on, insurance was only part of that. Equally as important were risk management information systems, so IT systems to back up the knowledge and understanding that they have of their risks; training in risk management, a significant number intending to increase their headcount in the risk management department; and then other things - business continuity, planning, risk mapping, things like that.

***What type of assistance are power companies looking for in managing risk?***

The things that are considered important were pretty much the same as across all the industries that were surveyed. Lessons learnt from other organisations, so understanding best practice was considered to be very important. Benchmarking data on comparable organisations was considered to be very important indeed. Tools and processes to help manage and understand the risks is important. Seminars and networking events around risk management themes. Generally, keeping track of risk management issues and insurer issues and in particular, the financial strength of insurers.

***So just summing up, from the findings of the risk report Mark and from your knowledge of power companies across the region, what must it be like to be involved in the management of a power company at this time?***

Well these are very complicated times for a risk manager but they are also very exciting times. Never has risk management been so high on the list of corporate priorities. Whereas in the past sometimes risk management has been considered to be just another corporate function, now risk management has become absolutely central to the strategic and operational objectives of companies. And as we have said, the most senior levels of companies, the boards of directors, are taking a direct interest in the risk management of the company.

So a risk manager with the rights tools at his disposal - with fresh ideas, with access to benchmarking, an understanding of best practice, able to compare his business with other businesses across the same industry - can really make a name for himself in this period. This really is a very exciting time indeed for a risk manager in a power company, indeed in any company.

***Mark Pollard, thank you.***

[END]

## About Marsh's Power and Utilities Industry Practice

With over 500 clients in 50 countries Marsh is the acknowledged market leader in the provision of insurance and risk management services to the international power and utilities sector. Our client base encompasses the whole spectrum of power and utilities, including vertically integrated nationalised industries, transmission and distribution companies, Independent Power Projects (IPP), Combined Heat and Power (CHP) projects, as well as nuclear and renewable energy companies. Fresh and waste water companies are also among our clients.

Our industry practice approach allows us to build a unique knowledge of the particular needs of power and utilities companies and to tailor our services and solutions accordingly. Services are delivered through a long established international network of centres of excellence and in-country industry specialists, many of whom have formerly worked in the power industry. These dedicated resources span all relevant disciplines including client servicing, insurance broking, risk engineering and risk management, and offers clients dynamic risk assessment, deep market relationships and bespoke consulting services.

Through our market relationships, industry knowledge and programme design capabilities, Marsh and MMC has a unique and unrivalled ability to assist power and utilities companies in minimising their total cost of risk by ensuring the optimum combination of risk retention, risk control and risk transfer.

For further information, please contact Mark Pollard, EMEA Power and Utilities Practice Leader, or your local Marsh office or visit our web site at: [www.marsh.co.uk](http://www.marsh.co.uk) or [www.marsh.com](http://www.marsh.com).

### **Mark Pollard**

*EMEA Power & Utilities Practice Leader*

Tel: + 39 02 48538 283

E-mail: [mark.pollard@marsh.com](mailto:mark.pollard@marsh.com)

Marsh is the world's leading risk and insurance services firm. We provide advice and transactional capabilities to clients through our 24,000 colleagues worldwide. This includes global risk management, risk consulting, insurance broking, financial solutions and insurance program management services for businesses, public entities, associations, professional services organizations, and private clients in over 100 countries. Marsh is a unit of MMC (Marsh & McLennan Companies), a global professional services firm providing advice and solutions in the areas of risk, strategy and human capital. It is the parent company of a number of world's leading risk experts and specialty consultants, including Guy Carpenter, the risk and reinsurance specialist; Kroll, the risk consulting firm; Mercer, the provider of HR and related financial advice and services; and Oliver Wyman, the management consultancy.

The information contained herein is based on sources we believe reliable and should be understood to be general risk management and insurance information only. Marsh makes no representations or warranties, expressed or implied, concerning the accuracy of information contained herein. The information is not intended to be taken as advice with respect to any individual situation and cannot be relied upon as such. Insureds should consult their insurance and legal advisors with respect to individual coverage issues. This document or any portion of the information it contains may not be copied or reproduced in any form without the permission of Marsh Ltd, except that clients of Marsh Ltd need not obtain such permission when using this report for their internal purposes.

In the United Kingdom, Marsh Ltd. is authorised and regulated by the Financial Services Authority for insurance mediation activities only. Marsh Ltd. is a subsidiary of Marsh Inc. Services delivered within each of the markets we operate within will be subject to local regulatory requirements.  
© Copyright 2009 Marsh Ltd All rights reserved